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No. 64

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In the

Supreme Court of the United States

OCTOBER TERM, 1969.

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF OF PETITIONERS ELMER E. MILLS AND LOUIS SUSMAN

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REPLY BRIEF OF PETITIONERS ELMER E. MILLS AND LOUIS SUSMAN

I. THE RESPONDENTS' VIOLATION IS NOT BEFORE THIS COURT FOR REVIEW.

A. Respondents' Argument on the Violation Is Improper.

The respondents have briefed the wrong issues. Like a ship in the night, their brief silently passes the questions presented by the Petition for Certiorari and de-

parts instead upon an uncharted course, apparently assuming that this Court will conduct a trial *de novo* of the whole action. From beginning to end, respondents' brief embodies this basic misconception. Its beginning states new and different "questions presented," seeking to raise new issues completely extraneous to anything in the petition. Its end is a prayer not that the judgment of the Court of Appeals be affirmed, but rather that it be *reversed.* The argument offered in its intervening pages must be disregarded on three grounds.

1. Only Questions Presented in the Petition Will Be Considered.

The Rules of this Court plainly prohibit such intrusion of extraneous issues. "Only the questions set forth in the petition or fairly comprised therein will be considered by the court." Rule 23.1(c); *see also* Rule 40.1(d)(2). The decisions enforce this Rule to its letter, declining to consider arguments beyond the scope of the questions presented. The principle is so clear and well-settled that its application is usually relegated to footnote treatment. *See, e.g., J. I. Case Co.* v. *Borak,* 377 U.S. 426, 428-29, 429 n.3 (1964); *United States* v. *O'Brien,* 391 U.S. 367, 368 n.31 (1968).

The Court's control of its own docket, concentrating its energies upon questions worthy of its attention, requires that argument here be confined strictly to questions which the Court has decided to consider in its grant of certiorari. Respondents' approach would convert this Court's rule into a trap for the unwary petitioner, who would scrupulously observe the limits of the questions presented in his opening brief only to be confronted with the task of meeting in a hurried reply brief every other issue which the respondents might choose to intrude. To countenance

he practice would unduly lengthen briefs and arguments, nd impede the prompt dispatch of that judicial business vhich the Court has found deserving of its time. For hese reasons, Mr. Justice Jackson forcefully reminded he bar, "We disapprove the practice of smuggling addi- ional questions into a case after we grant certiorari. The ssues here are fixed by the petition unless we limit the grant, as frequently we do to avoid settled, frivolous or state law questions." *Irvine* v. *California*, 347 U.S. 128, 129-30 (1954).

2. Without a Cross-Petition, Respondents Cannot Seek Reversal.

The questions presented by the petition raise, in various phrasings, the single question whether the Court of Appeals erred in holding that causation must be determined, in a case where a corporate merger was approved through unlawful proxy solicitation, by a factual finding that enough votes were changed by a specific misstatement or omission to change the outcome of the shareholder vote. In a separate portion of its opinion, under a separate heading, the Court of Appeals had held that respondents were guilty of violating the securities laws. The judgment below thus ruled in favor of respondents on the causation question, and in petitioners' favor on the question of the violation. The judgment of the District Court was accordingly affirmed in part and reversed in part, and the case was remanded solely for the purpose of further proceedings on the question of causation alone. Although respondents now protest the "serious consequences . . . of being branded a knowing violator of the law" (Resp. Br. 27), they made no attempt to obtain review of that decision despite its finality, by filing their own petition for certiorari. Nor did they even bother to

file a cross-petition, under this Court's Rule 21(3), when these petitioners sought certiorari. By-passing the need for this Court's consent to review that decision, respondents have nonetheless devoted their brief to arguments avowedly seeking reversal of the Court of Appeals judgment dealing with their violation.

Their brief must be disregarded. It is elementary that a respondent "is not entitled to be heard in opposition to the parts of the decision of the Court of Appeals which were adverse to it . . . but only in support of the parts which were in its favor. As to the former it has acquiesced and become concluded by not seasonably petitioning for a review." *Alexander* v. *Cosden Pipe Line Co.*, 290 U.S. 484, 487 (1934). *See also Lloyd Sabaudo, S.A.*, v. *Elting*, 287 U.S. 329, 331 (1932). "A respondent or an appellee may urge any matter appearing in the record in support of a judgment, but he may not attack it even upon grounds asserted in the court below, in an effort to have this Court reverse it, when he himself has not sought review of the whole judgment, or of that portion which is adverse to him." *LeTulle* v. *Scofield*, 308 U.S. 415, 421-22 (1940) (footnotes omitted).

Under these principles, the Court has repeatedly held that a defendant, as respondent, will not be heard to argue, without a cross-petition made and allowed, that the Court of Appeals' rejection of a defense was error and should be reversed. *See, e.g., Alaska Industrial Board* v. *Chugach Electrical Ass'n., Inc.*, 356 U.S. 320, 324-25 (1958), where this Court reversed the Court of Appeals order setting aside a workmen's compensation award, on the merits, and ruled that the argument that the award had been made beyond the board's jurisdiction was "not open to respondent at this stage." *Cf. Kellogg Co.* v.

National Biscuit Co., 305 U.S. 111, 122-23 (1938); *Morley Construction Co.* v. *Maryland Casualty Co.*, 300 U.S. 185, 190-92 (1937). Here respondents seek to go further, not merely to raise new and separate defenses on which the Court of Appeals might have reached the same result, but to reverse that result. The decision below unequivocally adjudicated a violation, and because of that violation directed that respondents would bear the burden of proof in further proceedings confined to the issue of causation alone. Respondents' arguments that the proxy statement made "full disclosure" and that any nondisclosure was trivial inevitably are pointed toward a reversal of the Court of Appeals decision, as they explicitly confess in their Conclusion (Resp. Br. 37), and elsewhere, (Resp. Br. 13, 19). Those arguments have no place in this Court.

3. Review of the Sufficiency of the Evidence to Support the Finding of Violation Is Foreclosed by the Two-Court Rule.

Respondents' argument that the proxy statement involved no violation of the securities laws must be disregarded on still a third ground. The question they now seek to raise is purely a question of the sufficiency of the uncontested evidence to support the finding of both courts below—and of all four judges—that the proxy statement was unlawful. Its resolution turned upon the unique contents of the particular proxy statement at issue, and upon specifics of the facts which were not disclosed. It raises no important question of federal law nor any possibility of conflict with decisions of other courts. The question whether these particular disclosures measured up to the demanding standards of federal law has no significance beyond the limits of this individual and unique case. Respondents' brief, dealing with facts not with law,

is an attempt to engage this Court in weighing the evidence. It asks the Court to scour a record of three volumes and more than a thousand pages, to decide a factual question already fully considered by two courts.

This Court does not sit to decide isolated and unique questions of fact. Certiorari on those issues, had respondents petitioned, would surely have been denied in adherence "to the usual rule of non-interference where conclusions of Circuit Courts of Appeals depend on appreciation of circumstances which admit of different interpretations." *FTC* v. *Standard Oil Co.*, 355 U.S. 396, 400, 401 (1958). The "two-court" rule, that concurrent findings of two lower courts will not be disturbed, suffices to support denial of certiorari and applies as well to foreclose consideration of the weight and sufficiency of evidence when a case is properly brought before this Court on other issues raising questions of law. *See Goodyear Tire & Rubber Co., Inc.* v. *Ray-O-Vac Co.*, 321 U.S. 275, 278 (1944); *Berenyi* v. *Immigration Service*, 385 U.S. 630, 635-36 (1967).[1]

B. If the Question of Violation Were Opened for Review, Petitioners Should Be Entitled to Brief and Argue That Issue.

The Rules of this Court require that briefs shall be directed only to the questions presented in the petition. Rule 40.1(d)(2). In obedience to this command, we

[1] This two-court rule was applied in *Baker* v. *Schofield*, 243 U.S. 114 (1917), to affirm a judgment holding that a defendant in a conflict-of-interest position will not be permitted "to take advantage of his own wrong" and holding that "he can take nothing by his wrongful act and can be compelled to restore the property. . . ." (pages 118, 119). Such relief is also appropriate here. See pp. 18-19, below.

refrain in this Reply from responding to the respondents' improper argument seeking to overturn the decision that they committed a violation of the securities laws. In this compliance, we rely upon the assurance in Rule 40.1(d)(2): "Questions not presented according to this paragraph will be disregarded, save as the court, at its option, may notice a plain error not presented." Should the Court be disposed to depart from its usual practice, and to consider the issue of the violation, petitioners request an opportunity to be heard on the issue, and to submit a full brief and argument, as we would have been entitled to do if certiorari had been regularly sought and granted on that question. An outline of such a brief is included as an appendix to this Reply, against any hypothetical argument that the two courts' finding of a violation might somehow be viewed as "plain error."

With this qualification, and in keeping with the practice in this Court, we have also refrained from making a separate motion asking the Court to strike the respondents' brief from the files, and have proceeded upon the premise that their improper argument "will be disregarded." Rule 40.1(d)(2).

II. DETERMINATION OF THE APPROPRIATE RELIEF IS NOT A PREREQUISITE TO ADJUDICATION OF LIABILITY AND WAS PROPERLY RESERVED FOR FUTURE PROCEEDINGS TO BE CONDUCTED UNDER THIS COURT'S GUIDELINES.

At the trial court level, this action embraced three distinct issues: (1) the violation of the proxy solicitation laws, (2) the causal relationship between the proxy solicitation and the merger, and (3) the relief to be granted. The first issue, concerning the violation, is not before this Court, for the reasons stated in the preceding section of

this Reply. The third issue, relating to the proper form of relief, has not yet been considered by the District Court, and has been reserved for further proceedings there. Only the second issue, of causation, is now presented for final decision.

Respondents, however, have devoted their brief wholly to the extraneous issues, as revealed by their Summary of Argument, 13-15. The first two paragraphs of that summary relate exclusively to the finding that respondents' proxy statement was in violation of federal law, a question not properly here. The remaining three paragraphs of that summary deal only with the relief to be granted, an issue not yet ripe. The brief is tantamount to a confession of error on the only issue properly before this Court: the question whether the Court of Appeals erred in its holding that causal relationship between the proxy solicitation and the merger was not established by the admitted fact that proxies produced by the unlawful solicitation were essential to approval of the merger.

A. Summary Judgment Was Properly Entered on the Issue of Liability Alone.

The question of the kind and quantity of relief to be afforded remains for future litigation and adjudication. The District Court determined only the issue of liability, leaving open the choice among available remedies, ranging from nominal damages only to a decree of divestiture. Respondents insist that it is somehow improper for a court to declare the underlying substantive rights without at the same time determining the remedy. *But see Brown* v. *Board of Education,* 347 U.S. 483 (1954). Thus they protest being "held liable" or being subjected to "automatic liability" without their "day in court" (Resp. Br. 20, 27-28) on questions which affect only the issue of

relief. It is not enough, in their view, that they are assured of a full and fair opportunity to litigate the question of the remedy in the future. In taking this position, respondents are quarreling not with the actions of the courts below, but with the rules of procedure promulgated by this Court. Rule 56(c), Fed. R. Civ. P., provides: "A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages." This salutary rule is intended to eliminate the waste of unnecessary trials on supposed issues drawn by the parties' contentions but not backed up by evidence, and to encourage the reasonable practice of narrowing the trial to issues fairly requiring it, and adjudicating in advance the paper issues resolvable on the uncontradicted facts. This Court's recent amendments confirm and reinforce the policy. *See* Advisory Committee Note, 31 F.R.D. 648 (1962); *First National Bank* v. *Cities Service Co.*, 391 U.S. 253, 289-90 (1968).

B. Relief After Unlawful Consummation of the Merger Is Not Foreclosed by Any Supposed Lack of Prompt Action by Petitioners.

Refusing to accept the separation of liability and remedy, respondents urge that the lower courts erred in finding a violation of the securities laws without first holding a trial on "the stage of transaction at which relief is sought (whether pre-vote or post-vote)." Resp. Br. 20. The question whether respondents violated the law cannot depend, in logic or in law, on the subsequent action of petitioners' filing suit, whether early or late. Since the date of filing affects neither the violation nor its causal relationship to the merger, respondents are apparently asserting that timing is relevant to the relief to be granted.

Aside from lack of legal merit, the claim that petitioners are chargeable with delay has no foundation in fact. The proxy statement was *mailed* on June 4, 1963 (A. 536), and the suit was filed on June 26, 1963 (A. 3), three weeks to the day from the moment when any minority shareholder could first have laid eyes on the proxy statement. In view of the complexity of that 108 page document and the duty to investigate before suit, as imposed by this Court (*see* Fed. R. Civ. P. 11), it verges on the ridiculous to suggest that petitioners deliberately conspired to "lie in wait" before filing suit. Resp. Br. 32. On the contrary, to one versed in the practical realities of law practice, such prompt filing in a complicated case would reflect extraordinary diligence. Moreover, respondents flatly misstate the record in reciting that " 'Several weeks' before the scheduled shareholder meeting, it was decided that a lawsuit would be filed." Resp. Br. 7, 23 n. 10. On the contrary, the record states that it was "about two or three weeks" after plaintiffs consulted their attorney before it was decided that the complaint would be filed. A. 853, 815-17.[2] Upon analysis, respondents' effort to weave a conspiracy among petitioners and their attorneys for "deliberate delay" in filing the suit, for some unstated purpose, is revealed as a figment of their misreading of the record.

Respondents also complain that petitioners did not bring the half-truths and omissions to the attention of the Auto-Lite management before the stockholders' meeting. Resp. Br. 7-8. Whether "management" knew of petitioners' suit before the meeting is not disclosed by the

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[2] The testimony cited by respondents does not refer to the time when the decision to sue was made, as respondents state to this Court, but rather to the time when the client made up his own mind that the merger was unfair. A. 829.

record, but respondents' off-the-record assertion of no notice (Resp. Br. 8) is difficult to reconcile with the fact, shown of record, that service of the summons and complaint was effected upon Auto-Lite's registered agent the day before that meeting. In any event, "management" certainly had full and peculiar knowledge of the facts omitted from the proxy statement, which they had presented in detail and under oath to the SEC in the separate proceeding under the Investment Company Act. A. 237. Respondents' argument is calculated to invert the congressional plan, and to impose upon the shareholder the duty to make full disclosure of all relevant facts to the corporate management.

On the same theme, respondents plaintively protest that petitioners did not seek and obtain a temporary restraining order, to stop them from their misdeeds. Although they were already twice enjoined, by statute and by the proxy rule, from obtaining merger approval through unlawful proxy solicitation, they assert they did no wrong absent a judicial order added to those legislative and administrative prohibitions. Petitioners' complaint prayed for a permanent injunction against use of the unlawfully solicited proxies and against consummation of the merger. A. 23-24. They did not file a motion for a temporary restraining order, for a number of good reasons. The requirement that an injunction bond be posted would have compelled them to risk their fortunes on the possibility that such a hasty and summary order would not later be set aside. Their chances of obtaining a valid restraining order were remote at best, in view of the strict limits imposed by this Court on such extraordinary relief.[3] Such an order will not be granted on a showing based on information and belief (*Bowles* v. *Montgomery Ward & Co.*, 143 F. 2d 38, 42 (1944)), the basis

[3] *See* Fed. R. Civ. P. 65.

of the original complaint here. A. 25-26, 846. The information which proved petitioners' charge and became the foundation of summary judgment was not discovered until months later, A. 828, 839, and shortly thereafter it was introduced by an amendment to the complaint. A. 169-71, 178. Until that evidence was discovered to support petitioners' charge, no injunctive action could have been taken, and petitioners can be charged with no lack of diligence. *See Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U.S. 238, 243 (1944).

Moreover, the lower courts typically take the position that a minority shareholder will suffer no irreparable harm if a meeting is held to count the ballots, since he can be adequately protected by retrospective relief, setting aside the vote, if full litigation reveals that a violation occurred.[4] *See, e.g., Mack* v. *Mishkin*, 172 F. Supp. 885, 889 (S.D.N.Y. 1959); *Sherman* v. *Posner*, 266 F. Supp. 871, 873 (S.D.N.Y. 1966). On the other hand, the defendant corporation may suffer irreparable harm if a restraining order is improperly granted, since a delay in the meeting will make the proxies stale and disfranchise new shareholders. *See Ainslie* v. *Sandquist*, 270 F. Supp. 382 (D. Mass. 1967); *Sherman* v. *Posner*, 266 F. Supp. 871, 874 (S.D.N.Y. 1966). Respondents would nonetheless urge this Court to adopt a rule requiring minority shareholders to seek emergency relief which they probably

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[4] These considerations were recently invoked by Mr. Justice Black in denying an application to him as a single Justice for an injunction against a public election. "If this election were held, applicants could later bring suit to have it set aside. I thus do not see why these plans should be stopped in midstream, in a case in which the legal issues are unclear, when the election cannot result in the severe irreparable harm necessary to justify the issuance of the extraordinary remedy of an injunction by an individual Justice." *Oden* v. *Brittain*, ... U.S. ....., 90 S. Ct. 4, 5 (August 13, 1969).

could not obtain, and encouraging the use of drastic and extraordinary remedies based on hurried and tentative hearings.

By the time petitioners could first have taken any action, the tainted proxies were already in the stockholders' hands and in the process of being executed and returned. The stockholders' meeting involved nothing more than the clerical task of tallying the proxy votes, and all votes counted were cast by proxy. A. 688. Whether the official vote count was completed before or after respondents learned of the suit is a matter of no consequence. At either time they were equally free to re-solicit the proxies with corrective or curative proxy materials.

Moreover, respondents do not carry their off-the-record assertions about management's knowledge to the extent of claiming that management was still ignorant of the suit when they acted to consummate the merger by turning over the assets, proceeding with the exchange of preferred shares and so forth. These steps were taken because respondents deliberately chose to persist in their violation, and to proceed despite full knowledge of the charges in the pending litigation. At any time they could have acknowledged the deficiency in their proxy statement, sent out a new statement, and held a new meeting. They decided instead to capitalize on the votes produced by unlawful proxy solicitation, and to risk the consequences. By a perversion of equitable principles, they now claim protection by reason of their wilful persistence in their wrongdoing. *Cf. Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U.S. 238, 247 (1944).

Respondents also seek to bring themselves under the shelter of protections for innocent third parties by asserting, off the record, that many persons have become

shareholders since the merger was voted upon. If such persons bought into the corporation without knowledge of the pending suit, the fault belongs to the respondents, who are responsible under federal law for disclosing information affecting the securities which they issue. In any event, their attempt to borrow a cloak of innocence defies the whole concept of the business corporation. In effect, they ask the Court to rule that a corporation can never be held accountable for its wrongs, because persons may have become shareholders without knowledge of the unlawful acts committed by management.

Respondents declare that "This Court should announce a rule promoting prompt action by persons having knowledge of defects in proxy material." Resp. Br. 36-37. They leave unstated the content of the rule which they urge, and their recommendations for the penalty if "prompt action" is not taken. In the light of the fact that the only "prompt action" not taken by petitioners was a motion for a temporary restraining order, and in the light of respondents' argument that liability cannot be adjudged without considering *when* "relief was sought" (Resp. Br. 20), respondents' suggestion emerges as nothing more than an elaborately disguised repetition of the rejected rule that the only relief which can be given for unlawful proxy solicitation is prospective. This rule had been adopted by the Sixth Circuit in *Dann* v. *Studebaker-Packard Corporation,* 288 F. 2d 201 (6th Cir. 1961). It was emphatically overruled by this Court in *J. I. Case Co.* v. *Borak,* 377 U. S. 426, 434 (1964), with its holding that there is no "merit in the contention that . . . remedies are limited to prospective relief." *See* Pet. Br. 60-61.

In sum, petitioners took prompt action at the earliest possible date consistent with a careful investigation and

consideration of their objections. Their legal position was fully and formally presented in a complaint, and was officially brought to the attention of respondents by means approved by the Court's procedural rules. Respondents were fully informed before they took any significant action to consummate the merger. If they had wanted a preliminary adjudication before they proceeded, they could have taken the initiative to obtain it, and cannot complain that petitioners did not indulge the futile gesture of seeking a temporary restraining order. If respondent's violation carries no consequences under these circumstances, and the lower courts can "attach no responsibility to the use of misleading proxy statements, the whole purpose of the section [§14] might be frustrated." *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 434-35 (1964).

C. Relief in the Form of Divestiture or Monetary Restitution Is Available Without Inquiry into the Fairness of the Exchange Ratio.

Although the question of the form of the final relief to be awarded is not presented for final decision at this stage, it is appropriate nevertheless for this Court to lay down the guidelines for the District Court's future determination of this issue, to hasten the ultimate disposition of this protracted litigation, to eliminate "the difficulty of fashioning effective relief . . . before remanding the case so that the trial court may go forward with further proceedings without undue delay", *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969), and to direct that the command of federal law *shall be enforced* according to its letter. *Cf. Alexander* v. *Holmes County Board of Education*, ... U.S. ....., No. 632 (Oct. 29, 1969).

Respondents attempt to raise up a straw man of "Draconian" extremism by insisting that petitioners are

arguing that "unwinding the merger" by a decree of divestiture is required in every case. Resp. Br. 15. As the opening brief makes clear (Pet Br. 64), petitioners take no such position. At the other extreme, respondents ask this Court to rule that the "remedy of rescission is not required under the facts of this case." Resp. Br. 36. Whether rescission in the sense of divestiture is "required under the facts" can be determined only after the facts are developed in the future hearings ordered by the District Court. To rule the remedy out of consideration now would "emasculate the securities laws by forbidding remedies which might prove to be essential." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 463-64 (1969).

Alternatively, the District Court may award monetary relief, as respondents concede. Of course, as the Government suggests, (Gov't Br. 17-18), petitioners would not necessarily be entitled to compensatory monetary relief by way of an award of substantial damages simply because a violation occurred. On the other hand, the availability of substantial monetary relief does not depend upon the "fairness" of the merger, in the sense of a fair ratio of exchange to be shown by the opinion of financial experts. Respondents themselves concede that substantial damages could be recovered, even though the merger were fair, if a misrepresentation pertains "to the very terms of the transaction". Resp. Br. 24. A misrepresentation which relates to the financial terms of the merger provides a ready and convenient measure of damages: the defendant can be compelled to live up to his promise by paying the difference. *See* Gov't. Br. 18. But such cases are likely to be rare in practice, since a flat misrepresentation of value would incur a grave risk of exposure. More common, and more insidious, are misstatements, half-

truths, and omissions which are not susceptible of direct, objective refutation. Most of the items of information required by the SEC's rules and regulations for proxy statements would be unrelated to the specific financial terms of a merger.[5] In these more common cases, one measure of damages might be provided by a re-examination of the fairness of the merger ratio, as the Government suggests. Gov't Br., 18-19.

But other measures of damages may be equally available. The respondents' out-of-hand dismissal of the law of restitution as "nothing more than a thinly-veiled attempt to recover damages without any inquiry as to injury" (Resp. Br. 34), ignores the most basic concepts of justice. See DAWSON, UNJUST ENRICHMENT, 3-5, [illegible] 14, 147-48 (1951). The restitutionary measure is unnecessary or inquired when other measures are impeded by difficulties of proof, where for example "the combined companies have been intermingled." Gov't Br. 18. *See* Fuller and Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L. J. 52, 374 (1937). It may be fairly supposed that Congress recognized such difficulties of proof, and shaped its language to avoid them, in declaring that contracts in violation of the proxy rules "shall be void . . . as regards the rights of any person" who engaged in the violation. Section 29(b), Securities Exchange Act of 1934, 48 Stat. 903. The fair intendment of this language is that, in assessing monetary relief, the parties should be restored financially to the position they would have occupied if there had been no merger, and more specifically, that the violator should take no right, benefit, or gain by his

[5] Schedule 14A promulgated under the Securities Exchange Act of 1934 (17 C.F.R. 240.14a-101), Items 1-6, 8, 12, 13, 16-21; *see also* Rule 14a-9, Note b, c, d (17 C.F.R. 240.14a-9).

violation of federal laws. This restitutionary remedy has been directly adopted by Congress for redress of the public disclosure provisions of the 1933 Act (Section 12, Securities Act of 1933, 48 Stat. 84), and is the obvious and logical remedy to be afforded by the courts under the 1934 Act in the enforcement of its public disclosure provisions. The SEC has recognized this in its recently proposed revision of Rule 133, to bring a merger proxy statement within the scope of the 1933 Act and its restitutionary remedy for a defective prospectus. *See* SEC Release No. 8711, Securities Exchange Act of 1934 (Oct. 9, 1969).[6] *See* Pet. Br. 29-32.

The courts, as well as Congress and the Commission, have found restitution to be an appropriate remedy for violations of the securities laws. Its availability does not depend upon whether the plaintiff might also have recovered upon a "fairness" measure of damages or not; for a proxy violation "the plaintiff is entitled to restitution" even though "the plan of merger was fair" in the sense that there were no "damages at the time of the sale of the stock." *Gerstle* v. *Gamble-Skogmo, Inc.*, 298 F. Supp. 66, 99-100 (E.D.N.Y. 1969). Even if the exchange appears fair when viewed at the time of transfer, restitution is afforded to deprive the violater of his ill-gotten gains and to redress his unjust enrichment by requiring him to disgorge his subsequent profits as the fruit of his wrong. Thus the First Circuit has said,

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[6] *See also* Securities Act Release No. 3761: "The Commission believes that in mergers, consolidations, transfers of assets and reclassifications of securities of the type which substantially affect the rights of security holders, such security holders are entitled to equivalent protection as that afforded by the registration provisions of the Securities Act of 1933."

"[If] the property is . . . sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." *Janigan* v. *Taylor,* 344 F.2d 781, 786 (1st Cir. 1965).

See also Myzel v. *Fields,* 386 F.2d 718, 746-48 (8th Cir. 1967), *cert. denied* 390 U.S. 951 (1968).

The measure of restitutionary damages is of course not necessarily the market value of the stock the minority shareholders were misled into relinquishing, nor value based on the earnings which they were receiving. We do not believe that the examples of possible measures of recovery offered in the Government's brief, 18-19, can be misread as intended to be an exhaustive enumeration, excluding other well-recognized measures. The illustrative mention of earnings as a common benchmark (Gov't. Br. 18), would not of course provide a valid measure in cases where the defendant has controlled the corporation and has been in a position to manipulate earnings to its own advantage. *See* McCormick, Damages §122, p. 457 (1935).

Here respondents admitted to the SEC in the Investment Company Act proceedings that they had exercised

major influence over Auto-Lite affairs since 1960. A. 358-59. With that control they chose to use the corporation's available cash not as working capital nor to achieve diversification as an escape from what respondents regard as the narrow and "fluctuating automotive market" (Resp. Br. 3): instead, they spent $20,000,000 of Auto-Lite's cash to buy its own stock (A. 57), to reduce the publicly-held portion and thus to help to bring their own holdings, as a proportion of the remaining stock, to more than 50%. This majority position was then employed to squeeze out the minority at a price pegged by the respondents. A well-known evil of the conglomerate is the seizure of large cash reserves for the use and benefit of the controlling interest. Against these circumstances, the remarks of the District Judge concerning the adverse effects of conglomerate mergers on the national economic interests carry a special cogency. In the light of these actions of respondents, it is not surprising that under their control "Auto-Lite had the lowest profit to asset ratio of 22 leading auto parts manufacturers." Resp. Br. 4.

In such a case, neither earnings nor market price is a reliable indicator of the true worth of the corporation assets, and book value is the proper measure. *See Developments in the Law: Damages* 1935-1947, 61 HARV. L. REV. 113, 126, 174 (1947). Respondents charge that use of book value is "absurd" (Resp. Br. 23 n. 9), despite the fact that the sale of at least one division of the corporate assets brought *twice* their book value, while the stock's market price stood at less than 75% of book. A. 36-37, 56. And while they insist that earnings afford the only correct measure, they compute the earnings of Mergenthaler by including amortized profit on the purchase of Auto-Lite shares, and measure that profit by the difference between

the market price paid and the higher book value. A. 76. By this device, they raised the stated earnings of Mergenthaler by 14%, to achieve a merger ratio they claim to be "fair". In short, book value is not "absurd" when used to show the merger to be "fair",—but only when it reveals the unfairness of the merger.[7]

To expedite the ultimate disposition of this controversy over respondents' continued insistence that "fairness" must control, this Court should re-affirm its approval of monetary restitution as an appropriate remedy, as already declared in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 434, (1964), clearing the way for a clean-cut and simple

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[7] Gurdon W. Wattles, who dominated the management of Mergenthaler (A. 412-13) and Auto-Lite (A. 415), testified before a Securities and Exchange Commission hearing examiner relative to the merger of three companies in which he had an interest (Century Investors, Inc., Webster Investors, Inc. and American Manufacturing Company) as follows:

"[I]n principle I would say this; that as far as we were concerned, we felt that the predominant factor in determining the relative division of interests in the merged company was based on assets and secondarily on earnings." A. 296.

"[B]asically we felt that the book value of the assets was a more important factor than the earnings. . . . So I would say that we felt that the major consideration should be the book value."

"We have been building these companies on a basis of assets, and we have over a period of years been able to create value through making use of these assets and converting them to better use. We have felt that provided the asset value was good, that for our purposes the asset value was of greater importance in determining this value than the immediate earnings which might not reflect what we felt it was possible to generate." A. 297.

measure of recovery of the violator's unlawful gains at the present true value of the assets unlawfully acquired. No exhaustive war of attrition, waged as a battle of expert opinion on the fairness of merger ratios, will then be required; in this sense, "fairness" is indeed irrelevant.

D. With the Final Adjudication of Liability, Petitioners Are Now Entitled to an Award of Litigation Expenses.

Although the question of final relief is not now ripe for final decision, the District Court has made a definitive disposition of the other issues. Both lower courts have made a final decision on the violation of the securities laws, and that question is closed. With that final decision, the petitioners are entitled at this stage to an award of reasonable litigation expenses incurred for the benefit of their corporation, for the reasons fully put forth by the Government in its brief, pp. 21-24. Reimbursement of such expenses is essential to the utility of the private action as a necessary and "effective weapon in the enforcement of the proxy requirements." *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964).

Because a violation has been finally established, petitioners are also entitled to an interim award for expenses incurred in future proceedings for determination of the appropriate relief, for the reasons fully developed in the brief of the Government, acting as amicus curiae at this Court's invitation. Gov't. Br. 19-21. Respondents' statement (Resp. Br. 32), that none of the authorities "support an interim award of fees" is incorrect. *See, e.g., Highway Truck Drivers & Helpers, Local 107* v. *Cohen*, 220 F. Supp. 735 (E. D. Pa. 1963), *aff'd*, 334 F.2d 378 (3d Cir. 1964), *cert. denied*, 379 U.S. 921 (1964).

III. THE ADMITTED FACT THAT UNLAWFUL PROXY SOLICITATION PRODUCED VOTES ESSENTIAL TO MERGER ESTABLISHES THE REQUIRED CAUSAL RELATIONSHIP.

Respondents make no serious attempt to defend or to support the decision of the Court of Appeals on the only aspect of the case now properly before this Court for final decision. On that single issue of causation, the rationale of the opinion here under review is not even stated in respondents' brief. An uninformed reader of that brief might well be led to the impression that the Court of Appeals had made some casual and off-hand remarks in passing about "misplaced emphasis" in proxy materials and about the niceties of typographical style and the usage of bold-faced type,* but that it had then proceeded to hold generally that liability was not established, and to remand for a general trial of all the relevant but unspecified "surrounding circumstances." That is not this case. The Court of Appeals devoted a major portion of its opinion, and its most careful attention, to the unequivocal holding that respondents' proxy statement, viewed as a whole, was materially misleading in violation of federal law. That holding was the predicate and founda-

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*This Court has recognized in other contexts that type sizes, bold-face print, and composition may produce a misleading effect. *Donaldson* v. *Read Magazine, Inc.*, 333 U.S. 178, 188-89 (1948):

> "Advertisements as a whole may be completely misleading although every sentence separately considered is literally true. This may be because things are omitted that should be said, or because advertisements are composed or purposefully printed in such way as to mislead. . . . Questions of fraud may be determined in the light of the effect advertisements would most probably produce on ordinary minds."

tion for imposing upon respondents the burden of proof in further proceedings on the question of liability, confined to causation alone. Under that decision, it would not be open to the trial judge on remand to conclude that the proxy statement made adequate disclosure or that its misstatements and omissions were trivial, immaterial, or purely technical. The doctrine of the Law of the Case would allow him to find no liability only by finding that the proxy statement did not "cause" the merger. Since respondents did not see fit to ask this Court to hear its objections to the decision on their violation, the Court of Appeals' judgment must stand or fall on the correctness of its decision on the question of causation.

Respondents' repeated assertion that there must be a vague and directionless trial of "all the relevant surrounding circumstances" before liability can be determined has no bearing on any issue before the Court. The term "circumstances"[9] is borrowed from Rule 14a-9, which defines the violation, not causation. The "circumstances" enumerated at page 20 and again at page 36 of their brief were all either fully considered by both courts below to the

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[9] Respondents' truncated quotation of Rule 14a-9 is the basis for their argument that "circumstances" surrounding the "proxy statement" are relevant to whether a violation was committed. They have parsed the Rule incorrectly. It is a "statement" contained *in* the proxy statement which is to be read in the light of its circumstances, that is, the other disclosures contained elsewhere in the proxy statement, and the external facts which determine its truth or falsity. "Circumstances" not revealed in the proxy statement cannot cure its misleading contents. The full Rule is set forth at page 3 of Petitioners' Brief.

extent that they relate to the violation,[10] or remain to be considered in the future to the extent that they concern the relief to be granted.[11] Thus the courts below have fully considered all their enumerated "circumstances" bearing on the causal relationship. The "attractiveness of the merger" (Resp. Br. 20, 36) has no relevance to the question of causation, for the reasons presented in Petitioners' Brief, *passim*. Respondents do not undertake to meet those reasons, nor to follow the Court of Appeals' tortuous conversion of causation into reliance into fairness. They ignore the fact that Congress eliminated reliance in the statutory scheme because "To encourage reliance we must dispense with its proof." Fuller and Perdue, *The Reliance Interest in Contract Damages: 1*, 46 YALE L.J. 52, 62 (1936).

Although they insist there should be a trial on "the percentage of the vote needed[12] and received" (Resp. Br. 20), respondents make no reference to the District Court's detailed findings of the undisputed facts on those "circum-

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[10] In this category are "the gravity of the omission" and "the nature of the matter being voted upon" (Resp. Br. 20), and "the disclosures which were made" and the unsupported and off-the-record "SEC's clearance of the proxy statement." Resp. Br. 36.

[11] In this category are "the interests of innocent third parties," the "stage of transaction at which relief is sought," Resp. Br. 20, and "deliberate delay," Resp, Br. 36.

[12] Respondents' statement that "96% of the shareholders voting favored the merger," Resp. Br. 8, takes on a very different meaning in light of the fact that a failure to vote constituted a negative vote. In fact, fewer than two-thirds of the minority shareholdings favored the merger, and the merger could not have been approved without the self-dealing votes of the shares owned by respondents, the adversary in the transaction. Under these circumstances, it can scarcely be said that the "Auto-Lite shareholders overwhelmingly approved . . . ." Resp. Br. 21.

stances." A. 687-88. They contradict this assertion that summary judgment was improper without a trial on these matters, however, by saying now that the facts were "never contested." Resp. Br. 10.[13]

It is thus undisputed and conceded that votes produced by the unlawful proxy solicitation were essential to approval of the merger. The "causal relationship of the proxy material and the merger," *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431 (1964), is established by the uncontradicted and uncontroverted facts, and summary judgment was properly entered in the absence of any genuine controversy on any fact material to the issue. The reference in the *Borak* opinion to this issue as a question of "fact to be resolved at the trial, not here" (377 U.S. at 431), was not intended to forbid summary judgment or to require a useless trial of undisputed fact. That case came before this Court at the pleading stage, and the quoted language merely embodies the Court's refusal to decide a fact question on pleading recitals.

Causation in fact is uncontested. As the Government cogently submits, the District Court's "objective test is not only practical and workable, but will serve to effectuate the underlying purposes of the proxy rules." Gov't Br. 14-15. Nothing more can be required in consonance with "the duty of the courts to be alert to provide such remedies

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[13] The statement that respondents "never contested" these facts is difficult to reconcile with their persistent refusal to admit them in response to petitioners' requests to admit under Rule 35. A. 467-503. These objections and refusals forced petitioners to resort to a motion to produce the minutes and attendance records of the shareholder meeting, in order to establish the facts "never contested." A. 505-521. Even then, respondents' objections forced petitioners' counsel to travel to Ohio to examine the documents. A. 521.

as are necessary to make effective the congressional purpose." *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433 (1964). The view of the Court of Appeals that causation would not exist if there were a preponderance of probability that the merger might still have been approved with a truthful proxy statement, A. 1013, is of doubtful vitality even as the rule obtaining in the Seventh Circuit. In *Swanson* v. *American Consumer Industries, Inc.*, C.C.H. Fed. Sec. L. Rep. ¶ 92, 458 (7th Cir. August 13, 1969), another panel of the court has subsequently declined to hold that causation was lacking even though the defendants owned 87% of the stock, more than enough to approve the merger, and even though it could thus be said with confidence that the merger would still have received a favorable vote with a truthful proxy statement.

CONCLUSION

For the foregoing reasons, the portions of Respondents' Brief dealing with their violation of the securities laws and seeking reversal of the Court of Appeals' judgment on that issue must be disregarded. The judgment of the Court of Appeals on the issue of causation should be vacated, and the judgment of the District Court should be affirmed.

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November 5, 1969.

APPENDIX

Outline of Argument
on
ISSUES BEYOND THE SCOPE OF THE PETITION FOR CERTIORARI

Full argument on these issues argued by respondents will be presented upon request of the Court.

INTRODUCTION: Factual errors and inaccuracies in Respondents' Statement of the Case.

I. UPON THE EVIDENCE, THE COURT OF APPEALS PROPERLY HELD THAT RESPONDENTS' PROXY STATEMENT VIOLATED THE PROXY RULES IN URGING THE AUTO-LITE DIRECTORS' RECOMMENDATION WITHOUT DISCLOSING THEIR RELATION TO MERGENTHALER.

A. The violation found by the Court of Appeals was not a failure to disclose the percentage of stock owned by respondents, but the failure to disclose that all the Auto-Lite directors were nominees of Mergenthaler, selected and deputed to serve the best interests of Mergenthaler.

B. Mere statement of the percentage of stock ownership did not constitute full and frank disclosure of domination through selection of all of Auto-Lite's directors and working control of its business management, as adjudicated by the SEC in proceedings under the Investment Company Act.

C. Beyond non-disclosure, the proxy statement was affirmatively false in stating, under the heading "Interests of Certain Persons in Matters To Be Acted Upon at the Meeting", that, apart from the four interlocking directors, "no director . . . has any substantial interest, direct or indirect, in any matter to be acted upon at the meeting . . . ."

D. Under *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), a fiduciary giving investment advice must disclose all facts creating a conflict of interest with a potential for abuse.

E. As representatives of the minority shareholders' adversary in the merger transaction, the Auto-Lite directors could not lawfully advise and recommend stockholder approval without disclosing their conflict-of-interest position, to allow the shareholders to evaluate for themselves the disinterestedness of the advice.

II. RESPONDENTS WERE ALSO GUILTY OF A *PER SE* VIOLATION OF THE PROXY RULES, UNNECESSARY FOR THE COURT OF APPEALS TO CONSIDER, IN FAILING TO DISCLOSE THAT CANDIDATES FOR THE BOARD OF DIRECTORS OF THE NEW CORPORATION WERE SUBJECT TO AN ARRANGEMENT AND UNDERSTANDING WITH A THIRD CORPORATION.

A. Since Mergenthaler directors would become directors of the merged corporation, the Auto-Lite shareholders were in fact electing them in voting on the merger, and were entitled to information bearing on their conflicts of interest.

B. The Mergenthaler directors were nominees of American, selected and deputed to represent its interests, and continuation of that arrangement and understanding was essential to American's exemption under the Investment Company Act.

C. The proxy rules explicitly and specifically required disclosure of this arrangement and understanding, and nondisclosure constituted a violation without any necessity for a finding that the omission was materially misleading.

D. The recital that American owned 33% of the Mergenthaler stock did not constitute full and fair disclosure of the arrangement and understanding whereby all Mergenthaler directors were nominees of American, selected and deputed to represent its interests.

III. A MERGER EFFECTUATED THROUGH A VIOLATION OF THE PROXY RULES GIVES RISE TO A FEDERAL CAUSE OF ACTION, AND A RIGHT TO APPROPRIATE RELIEF, IN FAVOR OF THE DEFRAUDED CORPORATION AND ITS SHAREHOLDERS WITHOUT REGARD TO THE UNFAIRNESS OF THE MERGER TERMS, FINANCIAL INJURY, OR OTHER ELEMENTS OF A COMMON LAW CAUSE OF ACTION.

IV. HONEST MOTIVES, GOOD FAITH, AND THE SOUNDNESS OF THE ADVICE DO NOT EXCUSE NONDISCLOSURE OF AN ADVISER'S CONFLICT OF INTEREST.

V. FAILURE OF THE SEC TO OBJECT TO A PROXY STATEMENT FILED WITH IT DOES NOT CONSTITUTE SEC APPROVAL, AND IS ENTITLED TO NO WEIGHT IN JUDICIAL PROCEEDINGS.

A. In view of the SEC's limitations of staff, time, and investigative facilities, its failure to take action against proxy materials carries no implication of approval, and Congress has explicitly forbidden any such implication in Section 26 of the Securities Exchange Act of 1934.

B. Within the realities of agency operation, it cannot be presumed that SEC staff members in the office of Corporate Analysis and Examination of the

Division of Corporation Finance, in reviewing the proxy statement, had knowledge of facts contained in the files of another proceeding, under a different corporate name, in the office of Investment Company Regulation in the Division of Corporate Regulation.

VI. SINCE THE FACTS OMITTED FROM THE PROXY STATEMENT WERE OFFICIALLY ADJUDICATED BY THE SEC AND ADMITTED BY RESPONDENTS TO BE TRUE, PARTIAL SUMMARY JUDGMENT ON THE ISSUE OF THE VIOLATION WAS PROPERLY ENTERED.